

## Message Text

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ACTION TRSE-00

INFO OCT-01 EUR-12 EA-10 ISO-00 SP-02 AID-05 EB-07 NSC-05

CIEP-02 SS-15 STR-04 OMB-01 CEA-01 CIAE-00 COME-00

FRB-01 INR-07 NSAE-00 XMB-04 OPIC-06 LAB-04 SIL-01

L-02 H-02 PA-02 PRS-01 USIA-15 /110 W

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R 141909Z FEB 75

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 8317

INFO AMEMBASSY PARIS

AMEMBASSY BONN

AMEMBASSY TOKYO

AMEMBASSY BERN

AMEMBASSY ROME

USMISSION OECD PARIS

USMISSION EC BRUSSELS

AMCONSUL HONG KONG

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DEPARTMENT PASS TREASURY AND FRB

E.O. 11652: N/A

TAGS: EFIN, UK

SUBJECT: EUROBOND MARKET PROSPECTS FOR 1975; THE VIEW  
FROM LONDON

REF: LONDON 2063; LONDON 2220 (NOTAL)

FOR JAMES GRIFFIN, TREASURY/OASIA, FROM JIM AMMERMAN

SUMMARY: SHIFT IN THE YIELD CURVE WITH DECLINE IN SHORT-  
TERM INTEREST RATES, AND BETTER EXPECTED OUTLOOK IN THE  
NEXT TWELVE TO EIGHTEEN MONTHS FOR CONTROL OF INFLATION  
HAVE ALREADY HELPED BRING RENEWED ACTIVITY INTO THE EURO-  
BOND MARKET. WELL-KNOWN WEAKNESSES OF THE MARKET, I.E.,  
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LACK OF STRONG INSTITUTIONAL INVESTOR PARTICIPATION,

NARROWNESS OF SECONDARY MARKET ACTIVITY INCLUDING LACK OF MARKET MAKERS DEALING ON THEIR OWN BEHALF, SMALL SIZE OF ISSUES REMAIN IMPEDIMENTS. REMOVAL OF U.S. CONTROLS HAS SHIFTED MUCH U.S. CORPORATE BORROWING BACK TO THE U.S. CONSIDERABLE SUPPORT FOR NEW ISSUES CONTINUES TO BE FROM WEALTHY PRIVATE INVESTORS ATTRACTED BY ABSENCE OF WITH-HOLDING TAX. ARAB FINANCIAL INSTITUTIONS ARE PLAYING AN INCREASING ROLE IN UNDERWRITING AND PLACING. STRENGTHS OF THE MARKET ARE ITS FLEXIBILITY; ABILITY TO DENOMINATE ISSUES EITHER IN EUROPEAN OR U.S. CURRENCIES, UNITS OF ACCOUNT, EUROPEAN CURRENCY UNITS, EUROCOS, AND MIDDLE EASTERN CURRENCIES AS WELL AS LACK OF ANY MEANINGFUL GOVERNMENTAL CONTROLS. INCREASING SHIFT OF UNDERWRITING AND TRADING ACTIVITY (AS DISTINCT FROM LISTING) AWAY FROM LONDON TOWARDS PARIS, GENEVA AND MIDDLE EAST ALSO NOTED. INCREASED ACTIVITY IN 1975 OVER 1974 TAKEN AS CERTAINTY; QUANTITATIVE ESTIMATES NOT AVAILABLE BUT OBSERVERS BELIEVE AMOUNTS RAISED THIS YEAR WILL LIKELY EXCEED 2.5 BILLION DOLLAR EQUIVALENT WITH HIGHER PROPORTION OF FOREIGN CURRENCY DENOMINATION THROUGH FIRST HALF 1975 AT LEAST, PROBABLY SHIFTING TO HIGHER PROPORTION IN DOLLAR DENOMINATION IN SECOND HALF OF YEAR AS DOLLAR STRENGTHENS. END SUMMARY.

1. FINANCIAL ATTACHE HAS DISCUSSED OUTLOOK WITH U.S., U.K. AND SWISS UNDERWRITERS. THEY REPORT THERE IS NO FORMAL QUALITY RATING AVAILABLE ON EUROBOND ISSUES; SINCE REMOVAL OF U.S. CONTROLS, MARKET MUST BE ANALYZED IN TERMS OF U.S. BORROWER ACTIVITY AND FOREIGN BORROWER ACTIVITY. A NAME U.S. BORROWER IN THE EUROMARKET IS VIEWED IN TERMS OF ITS OWN OR ITS PARENT'S STANDARD AND POOR OR MOODY RATINGS. UNDERWRITERS FREQUENTLY WILL NOTE THAT BORROWER IS DOUBLE A OR SINGLE A COMPANY IN THE U.S.' ALTHOUGH THE RULE OF THUMB RATE SPREADS GOVERNING DIFFERENT CATEGORIES IN THE U.S. MAY NOT BE AS SHARP IN EUROBOND ISSUES. RATINGS FOR EUROPEAN AND OTHER NON-U.S. ISSUERS TEND TO REFLECT JUDGMENTS OF MAJOR FINANCIAL INSTITUTIONS THAT SERVICE BORROWING COMPANIES IN THEIR HOME COUNTRIES. BALANCE SHEET AND PROFIT AND LOSS ANALYSIS OF THESE NON-U.S. BORROWERS IS MORE DIFFICULT AND SUBJECTIVE. INTEREST UNCLASSIFIED

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RATE, MATURITY, AND SINKING FUND PROVISIONS ATTACHED TO THE ISSUE TEND TO REFLECT THE MARKETS RATING JUDGMENT OF THE BORROWER. SOME INVESTMENT HOUSES BEMOAN THE LACK OF A STANDARD AND POORS OR MOODY'S TYPE RATING FOR EUROBOND ISSUES.

2. THE DECLINE IN SHORT-TERM RATES AND RELATIVE IMPROVEMENT IN INFLATIONARY OUTLOOK HAS CREATED BETTER ENVIRON-

MENT FOR EUROBOND MARKET THIS YEAR. CURRENT DIFFICULTIES  
OF INTERNATIONAL BANKING SYSTEM IN PUTTING TOGETHER LARGE  
SYNDICATED ISSUES DUE IN SOME PART TO THE DIVERSE FUNDING  
RATES(FOR DIFFERING CATEGORIES OF BANKS) HAS PLAYED A PART  
IN RENEWED BORROWER INTEREST IN EUROBOND MARKET. GOOD  
NAME PROSPECTIVE BORROWERS ARE BEING ADVISED BY UNDER-  
WRITERS TO TAKE ADVANTAGE OF CURRENT STATE OF MARKETS IN  
ORDER TO OBTAIN LONG-TERM FUNDS WHILE AVAILABLE RATHER

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R 141909Z FEB 75

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 8318

INFO AMEMBASSY PARIS

AMEMBASSY BONN

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THAN WAIT ANY LONGER FOR RATES TO FALL. WILLINGNESS OF  
SOME SUBSCRIBERS TO PLACE MONEY LONGER TERM ALSO REPORTED.  
MARKET IS STILL INHIBITED BY THE GENERALLY SMALL SIZE OF

ISSUES THAT CAN BE PLACED, I.E., \$25 TO \$50 MILLION RANGE. THIS MUCH SAID, SOURCES INDICATE DOLLAR ISSUES AT 9-1/2 PERCENT INTEREST WITH 7 TO 8 YEAR MATURITIES AND DM ISSUES AT 9 PERCENT WITH MATURITIES TO TEN TO TWELVE YEARS ARE OBTAINABLE, WITH PROSPECTIVE BORROWERS ARRANGING BOTH TYPES WITH UNDERWRITERS.

3. MANY UNDERCURRENTS ARE DISCERNABLE AND DIFFERING VIEWS ARE HELD. SOME UNDERWRITERS SEE THE EUROBOND MARKET DEVELOPING INTO A SECOND-CLASS MARKET FOR COMPANIES THAT EITHER CANNOT RAISE FUNDS IN NEW YORK OR THAT DO NOT UNCLASSIFIED

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WISH TO MEET THE REQUIREMENTS OF U.S. REGULATORY AUTHORITIES. REMOVAL OF U.S. CONTROLS AND ABILITY OF U.S. AND PRIME FOREIGN BORROWERS TO FUND FOREIGN ACTIVITIES FROM THE U.S. HAS CHANGED COMPLEXION AND OUTLOOK FOR FUTURE MARKET DEVELOPMENT. NOT ALL UNDERWRITERS AGREE ON THIS POINT HOWEVER AND SOME CONSIDER THAT RECENT EUROBOND ISSUERS HAVE BEEN PRIME SOVEREIGN RISKS OR FIRST CLASS EUROPEAN CORPORATE AND FINANCIAL ISSUERS. UNDERWRITERS ARE MORE CONSCIOUS OF QUALITY CONSIDERATIONS AFTER 1969-1971 DEBACLES. MAIN ATTRACTION FOR PRIVATE SUBSCRIBERS TO THE ISSUES IS FREEDOM FROM WITHHOLDING TAX. IF U.S. GOVERNMENT WERE TO REMOVE ITS WITHHOLDING TAX REQUIREMENTS ON FOREIGN PRIVATE PURCHASERS OF U.S. PORTFOLIO INVESTMENT, THERE COULD BE, IF NOT A NEW BALL GAME, AT LEAST ANOTHER MAJOR ELEMENT TO BE ADDED INTO ASSESSMENT OF OUTLOOK FOR EUROBOND MARKET.

4. THE MAJOR AND WELL-KNOWN STRUCTURAL WEAKNESS UNDERLYING THE EUROBOND MARKET REMAIN, I.E., LIMITED INSTITUTIONAL INVOLVEMENT AND LACK OF BREADTH IN THE SECONDARY MARKET. THOSE FIRMS WHICH HAD MADE A SECONDARY MARKET IN EUROBONDS BY MAINTAINING THEIR OWN INVENTORIES (INCLUDING WESTERN AMERICAN BANKING CORPORATION AND ORION) SUFFERED LOSSES FROM SO DOING. VIEWS RANGE FROM UNCERTAIN TO UNLIKELY THAT MAJOR HOUSES WILL AGAIN BE WILLING TO TRADE IN ANY SIGNIFICANT VOLUME ON THEIR OWN ACCOUNT; ON BALANCE VIEWS ARE THAT MARKET MAKING WILL BE LIMITED TO INTERMEDIARY, BROKING ROLE OF ATTEMPTING TO BRING TOGETHER BUYERS AND SELLERS, WITHOUT MAINTAINING INVENTORIES.

5. ONE ELEMENT CITED AS A STRENGTH IS THE MARKET'S FLEXIBILITY IN TAILORING ISSUES TO THE NEEDS OF AN ISSUER OR BUYER AND GROWING OPEC INVOLVEMENT IN NEW ISSUES. CURRENT QUESTION OF KUWAIT AND OTHER ARAB NON-INVOLVEMENT IN ISSUES INVOLVING EUROPEAN UNDERWRITERS ON BOYCOTT LIST IS AN UNCERTAINTY THAT UNDERWRITERS HERE EXPECT CAN BE RE-

SOLVED, BUT THEY ARE NOT CERTAIN HOW.

6. DEMAND FOR ISSUES COMES FROM WEALTHY PRIVATE ARABS,  
IN PART THROUGH SWISS BANKS IN GENEVA AS WELL AS FROM  
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PRIVATE ITALIAN AND BELGIAN INVESTORS. AS A PERCENTAGE  
OF ACTIVITY, TAKING INTO ACCOUNT PREVIOUS U.S. BORROWERS  
WHICH ARE NO LONGER IN THE MARKET. LONDON'S ROLE IS  
BEING REDUCED IN FAVOR OF NEW YORK, PARIS GENEVA AND  
MIDDLE EAST.

7. UNDERWRITERS EXPECT INTEREST RATES TO INCREASE WITH A  
RESURGENCE OF INFLATION IN 1976 AND 1977. THEY SEE DIFFI-

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ACTION TRSE-00

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L-02 H-02 PA-02 PRS-01 USIA-15 /110 W

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R 141909Z FEB 75

FM AMEMBASSY LONDON  
TO SECSTATE WASHDC 8319  
INFO AMEMBASSY PARIS  
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CULTIES IN ADVISING CLIENTS TO PURCHASE CURRENT ISSUES IF CLIENTS INTEND TO BE ACTIVE IN TRADING THEM DURING THE NEXT FEW YEARS, BUT DO RECOMMEND SUCH ISSUES FOR PURCHASE AND MAINTENANCE OVER TIME IN A PORTFOLIO WHERE THE BUYER IS INTERESTED IN GOOD NAME ISSUERS, SECURITY OF PRINCIPAL AND A REASONABLY HIGH RETURN BASED ON HISTORIC YIELDS. THE SMALL TOTAL SIZE OF SOME OF THE ISSUES MAKE THEM TOO SMALL FOR THE ACTUARIAL OR TRADING REQUIREMENTS OF SOME LARGER INSTITUTIONAL INVESTORS; GIVEN THE WEAK SECONDARY MARKETS FOR THE ISSUES, THEY ARE BASICALLY ILLIQUID. AN INSTITUTIONAL INVESTOR SEEKING TO DISPOSE OF A GOOD SIZED PROPORTION OF A SINGLE ISSUE (WHICH AT ONLY \$2.5 TO \$5 MILLION IN VALUE COULD STILL BE FROM 10 TO 20 PERCENT OF THE ISSUE) AT A GIVEN POINT IN TIME WOULD ALMOST CERTAINLY UNCLASSIFIED

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UNSETTLE THE MARKET PRICE.

8. LOOKING AHEAD MOST OBSERVERS HERE EXPECT STRENGTHENED ACTIVITY IN THE EUROBOND MARKET THIS YEAR AFTER LAST YEAR'S DISMAL PERFORMANCE ("1974--THE YEAR THE EUROBOND MARKET NEARLY DIED" IS TITLE OF AN ARTICLE IN FEBRUARY ISSUE OF EUROMONEY) NO QUANTITATIVE ESTIMATE OF ACTIVITY IS AVAILABLE; MOST GUESSES ARE AT LEAST \$2.5 BILLION OR MORE IN TOTAL ACTIVITY, AN INCREASE OF 25 PERCENT ON 1974 BUT STILL WELL BELOW 1972 AND 1973 TOTALS. GENERAL OUT-LOOK IS ONE OF LESS PESSIMISM, DECREASED LACK OF CONFIDENCE. A HIGHER PORTION OF EURO BONDS DENOMINATED IN NON-DOLLAR CURRENCIES THROUGH THE FIRST HALF OF 1975 AND A SHIFT INTO A HIGHER PROPORTION IN DOLLAR DENOMINATIONS IN THE SECOND HALF YEAR IF THE DOLLAR STRENGTHENS IS SEEN AS A POSSIBILITY, BUT BY NO MEANS A CERTAINTY.

9. ASSISTANT FINANCIAL ATTACHE WILL HAVE FURTHER DISCUSSIONS NEXT WEEK, WILL REPORT FURTHER IF ADDITIONAL VIEWS ARE HEARD. ABOVE VIEWS COME FROM VERY WELL PLACED AND RELIABLE SOURCES, THEY ARE OUR BEST JUDGMENT OF MARKET OPINION, BUT AS ALWAYS SHOULD BE CONSIDERED CRITICALLY. INFORMATION ADDRESSEES MIGHT ALSO CARE TO COMMENT. UNDERWRITERS IN LONDON ARE VERY WELL INFORMED BUT ACKNOWLEDGE THEY MAY NOT BE AWARE OF THE ENTIRE SHIFTING STRUCTURE OF MARKET DEVELOPMENTS OUTLINED ABOVE. NO SINGLE SOURCE SEES THE ENTIRE PICTURE.  
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## Message Attributes

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